

Response to IPAA Letter dated December 2, 1999

Date: December 29, 1999

The following question and answer format is provided in response to the letter recently forwarded from the Independent Petroleum Association of America regarding the Emergency Oil and Gas Guaranteed Loan Program. Certain additional pertinent queries have also been added for informational purposes:

Application Process

Question #1: *The deadline for delivery of application under the program seems to be very short. Can the deadline be extended or can future applications windows made available?*

Response: The Board recognized the industry's concerns in meeting the initially imposed December 30, 1999 deadline and has extended the deadline to January 31, 2000.

Ref. to Reg.: See Sec. 500.205(a) [as amended]

Question #2: *Can the application, once submitted, be amended or changed after the application deadline?*

Response: No. The Program is structured to receive all applications by the same deadline and then review and assess them as a whole. Given the fact that an early response time by the Board is considered crucial, no allowance can be made for subsequent modifications of applications.

Refer to Reg.: See Sec. 500.205

Question #3: *Can an applicant Lender submit materials after the first application?*

Response: No. This question covers an issue similar that raised in Question #2 above. The Board, in its sole discretion, may seek further clarification from applicants, however.

Refer to Reg.: See Sec. 500.205

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Question #4: *There seems to be a significant amount of documentation required along with the application. Is all of this necessary? Why not just rely on the Lenders to make the decision regarding what information is needed and important?*

Response: The Board does place a great deal of reliance on the Lenders to make sound, prudent lending decisions regarding the transactions underlying the applications as the Lenders will retain residual risk. However, as the Board is accepting a significant potential exposure, it is prudent on our part to be privy to the same information that the Lenders have utilized in making their determinations. This information will be used in the Board's own review and credit assessment process.

Refer to Reg.: See Sec. 500.205(b)

Question #5: *Audited financial statements may not be in place for all potential independent oil company applicants. Is this necessary?*

Response: The Board recognized the difficulty for the smaller independent oil and gas companies of meeting this requirement and revised the regulations accordingly. Audits will be required annually going forward for those Borrowers under the Program.
Service companies applying under the Program will still need to provide audited financial statements for the 3-year prior period.

Refer to Reg.: See Sec. 500.205(b)(8) [as amended]

Question #6: *Can IRS-submitted tax records and P&L statements be used for loan applications, if judged acceptable by the Lender?*

Response: No. The Regulations are clear and specific on the requirements for financial reporting. This information is viewed as critical by the Board in its review and assessment of the underlying transactions.

Refer to Reg.: See Sec. 500.205 (b)(8)

Question #7: *How current must the underlying reserve report presented by Borrower be?*

Response: All vital supporting information, including the reserve report, should be as current as practically available. The Board is relying on the Lenders to make prudent credit decisions before submitting an application and clearly

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such decisions require as up-to-date information as possible. The Board can accept reserve reports dated greater than one year; however, we are likely to significantly discount its "value" in the credit evaluation and grading process.

Refer to Reg.: See Sec. 500.204(b)(9)

Question #8: *Why are financial projections needed?*

Response: As clearly stated in the legislation, one of the main requirements for a loan guarantee is that the prospective earnings power of the Borrower furnish reasonable assurance of repayment. Evidence of an ability to repay the underlying loan under reasonable and normal business conditions must be demonstrated. Once again, such information is considered a reasonable underwriting practice by prudent Lenders.

Refer to Reg.: See Sec. 500.205(b)(9)

Question #9: *Could you explain what is needed to comply with the environmental reporting section of the Regulations?*

Response: The Board has adopted the National Environmental Policy Act (NEPA) procedures. Normal and customary environmental data or documentation concerning the use of proceeds must be provided by the Lender. This information will be used by the Board in completing an environmental assessment of the project. (A copy of the NEPA environmental assessment form is contained on our website at www.doc.gov) Different types of transactions will trigger the Board's NEPA procedures. Please refer to the Regulations for a more specific description of the applicable environmental information requirements.

Refer to Reg.: See Sec. 500.206 (as amended)

Question #10: *What is the confidentiality of information submitted?*

Response: The Program is subject to the Freedom of Information Act (FOIA). The Borrower and Lender can make request for confidential treatment of business information provided to the Board. The Regulations provide guidance as to how to proceed in this fashion. Basically, the applicant needs state clearly why any information is considered confidential and mark each piece of confidential information as "PROPRIETARY" or

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Refer to Reg.: "BUSINESS CONFIDENTIAL."
See Sec. 500.107(g)

Eligibility Requirements – Borrowers and Lenders

Question #11: *Would you please explain the definition of "Qualified Oil and Gas Company" as it relates to an independent oil and gas company and an oil field service company?*

Response: In an attempt to provide an industry definition, the legislation stipulates that (i) an *independent oil and gas company* must have operations that conform to the definition of intangible drilling and development costs as defined in the appropriate IRS code; and (ii) and an *oil field service company* must (a) operate in an oil field service line of business and (b) be defined as a small business under the Small Business Act. The basic criteria under the applicable SBA provision is that a company not be dominant in its field.

Refer to Reg.: See Sec. 500.2(k)

Question #12: *Why must a Borrower get a "turn down" letter from a third-party bank?*

Response: The underlying legislation establishing the Program is clear in its intent to provide assistance to those companies in the industry that can not otherwise obtain credit or investment capital under reasonable terms. As a result, evidence must be provided that indicates that credit under similar terms is not available. Such a confirmation from a third-party bank is deemed necessary to establish need as required under the legislation.

Refer to Reg.: See Sec. 500.200(b)

Question #13: *If a Borrower presently has a loan relationship with a bank, why can it not apply with this bank for a refinancing of the existing loan?*

Response: The intent of the Program is to provide assistance to those companies that can not otherwise readily obtain credit or investment capital. The Program is not established to provide a means of assisting or "bailing-out" Lenders via governmental credit-enhancement of pre-existing loans. Refinancing of existing debt is a valid use of proceeds under the program; however, the requirement to refinance through third-party debt is in place to protect

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against this possibility.
Refer to Reg.: See Sec. 500.201(c)

Question #14: *How will relatively new entrants into the industry be treated? What if a company does not possess the required information dating back to January 1, 1997?*

Response: Once again, the intent of the program is to provide assistance to those companies that have suffered through the most recent industry downturn. The program is not in place to provide assistance to recent start-ups, new special-purpose companies, or the like. The Board has established January 1, 1997 as a representative start-date for determining the period of economic hardship. A potential Borrower should provide confirmation that it was operational during a significant portion of the recent industry downturn and was in fact negatively impacted during this period.

Refer to Reg.: See Sec. 500.200 and Sec. 500.205(b)(8)

Question #15: *Can companies apply together?*

Response: If the intent is to establish a new special-purpose borrowing vehicle jointly-owned by various distinct entities, the answer is likely no. If the intent is to assist in the merger of two or more otherwise eligible companies, then the Program will most likely be able to facilitate such transactions.

Refer to Reg.: See Sec. 500.200

Question #16: *What if federal taxes are being currently challenged by the Borrower and no agreement has been reached at time of application?*

Response: As long as the tax dispute is being pursued in the appropriate manner prescribed by the IRS under its regulations, and a judgment has not been rendered against the Borrower, such tax challenge will normally be considered to be in the ordinary course of business.

Refer to Reg.: See Sec. 500.205(c)

Question #17: *Is there a list of banks interested in providing loans under the Program?*

Response: No. Given the short time frame that the Program has operated under, no list of potentially interested Lenders has been developed.

Refer to Reg.: See Sec. 500.201

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Loan Structure / Transaction Eligibility Requirements

Question #18: *What are the structural requirements for repayment of the underlying loan?*
Response: Functionally none, other than the requirement of an absolute final maturity limit of December 31, 2010. However, it is clearly incumbent upon the Lenders to forward applications that provide for a reasonable means of repayment. The ability to repay under reasonable business conditions is a key part of the Board's review/assessment and credit evaluation process.

Refer to Reg.: See Sec. 500.204(a)

Question #19: *How will an application be evaluated if a Lender uses a Mezzanine-type vehicle?*

Response: There is no stipulated prohibition against the use of "mezzanine"-type vehicles in the structure of the underlying loan request. However, the overall risk profile of the business operation will form a major component of the Board's final credit decision. We would urge caution in making application for transactions that clearly go well beyond the scope of normal bank lending standards. It is also important to make sure that the Lender's rate of return is appropriate for the risk level assumed.

Refer to Reg.: See Sec. 500.207(b)

Question #20: *How will an application be evaluated if the Lender, due to the presence of the Board guarantee, allows for a more aggressive asset value coverage on PDP's, PDNP's, PUD's?*

Response: This question is similar in nature to *Question #19* above. The Board assumes that the Lender will make an appropriate decision regarding the acceptable risk profile of the underlying transaction due to its retained interest in the deal. The Board does, however, retain the right to make its own decision regarding the risk it is willing to accept under the Program.

Refer to Reg.: See Sec. 500.207(b)

Question #21: *Can the loans be structured as non-recourse?*

Response: It is assumed that the application will be made on behalf of a Borrower

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- meeting the fundamental eligibility requirements. The underlying loan will obviously be made recourse to the Borrower. The decision to provide recourse to other interested parties needs to be made by the Lender in its credit evaluation process. The Board will evaluate each proposal on its merits and the abundance of collateral support is clearly beneficial.
- Refer to Reg.:* See Sec. 500.204
- Question #22:** *Does the Board have first priority on the loans or pari passu?*
- Response:* The Borrower's obligations under the Loan must be secured by a perfected first lien on property of the Borrower. The Lender(s) and the Board will essentially share in any proceeds of the collection of collateral on a *pari passu* basis.
- Refer to Reg.:* See Sec. 500.204(c)
- Question #23:** *What are acceptable interest rates and fees that Lenders can charge for these loans?*
- Response:* There are no pre-determined limits. The material test for the Board will be if the interest rate and fees are judged to be reasonable and customary given the perceived level of risk of the underlying transaction. The rate charged by the Lender should also take into consideration the fact that a significant portion of the loan carries a Board guarantee. It is the intent of the Board to see that the Borrower receives a competitively priced facility.
- Refer to Reg.:* See Sec. 500.204(b)
- Question #24:** *Is it possible to have some additional collateral pledged (directly or through a cross collateralization) to the benefit of the Lender first and to the Board second?*
- Response:* No. The Board will not accept a position that is in any way subordinated to other parties. Further, the Regulations clearly state "the unguaranteed portion of the loan will neither be paid first nor given any preference over the guaranteed portion".
- Refer to Reg.:* See Sec. 500.204(c)
- Question #25:** *Will the Board consider surface equipment as collateral? Additionally, are personal guarantees acceptable?*

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Response: Once again, the Board defers to the Lender to make the determination of what is acceptable collateral supporting the loan. The addition of surface equipment to the collateral pool would be considered acceptable. Regarding personal guarantees, the same principal applies. The Board will consider such personal guarantees as credit support, with valid supporting documentation (i.e., current personal financial statements.)

Refer to Reg.: See Sec. 500.204

Question #26: *If a market exists for the syndication of these loans, what are the limitations of the program?*

Response: The Board will allow for primary syndication of the loan under normal and customary bank practices. Secondary sales of the loan through assignment will necessitate Board approval. Additionally, any subsequent transfer can only be to a designated Eligible Lender.

Refer to Reg.: See Sec. 500.210

Question #27: *Is the Board guarantee available to support accrued interest?*

Response: The legislation covering this issue is clear. [see Sec 201(f)(4) of the legislation] The Board guarantee can relate only to principal and not interest due under the loan. For example, in the case of a proposed zero coupon loan, only the issue price would be guaranteed up to a maximum of 85%.

Refer to Reg.: See Sec. 500.2(f)

Application Evaluation / Issuance of the Guarantee

Question #28: *How long will the approval process take? Is there a firm date from the close of the application window to the issuance of the guarantees?*

Response: It is the goal of the Board to make final its decisions regarding approved and declined applications as soon as practically possible. There is no firm target date at this time due to the fact that the timeliness of the process is in large part dependent on the market's response (i.e., the number of applications received.) All applications will be processed at the same time. A goal of the Board staff is to have the approval process completed within

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Refer to Reg.: 90 days of the application deadline.
See Sec. 500.207(c)

Question #29: *How will the Borrower be notified of a rejection or acceptance? Can the Borrower re-apply in a subsequent application window, if guarantees are still available?*

Response: The Board will notify the Lenders in writing of the approval or denial of the application. As provided for in the legislation, the authority of the Board to issue guarantees under the Program terminates upon expiration of either the December 31, 2001 time deadline or upon reaching the stated statutory dollar limits (the \$500,000,000 notional loan limit or the \$122,500,000 loan loss limit). If the limit is not reached during the first application window, the Board retains the right to reopen subsequent windows. No such action is contemplated at this time.

Refer to Reg.: See Sec. 500.207(c)

Question #30: *Can loans be applied for by different banks on the same loans?*

Response: If this issue relates to the syndication or multiple participation by banks in the same loan transaction, this is considered acceptable. If this issue relates to the possibility of a single borrower presenting multiple applications from various lenders, the Board will review only one application per Borrower.

Refer to Reg.: See Sec. 500.201

Lender Responsibilities

Question #31: *Why is it necessary for the Lender to submit quarterly compliance certificates?*

Response: The Board views the Lender as the principal manager of the credit relationship with the Borrower. The quarterly reports are viewed as a means of making sure that the Lenders maintain proper vigilance.

Refer to Reg.: See Sec. 500.211(f)

Question #32: *Who may act to force acceleration of a loan in the event of default?*

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Response: Under the terms of the Guarantee Agreement, the decision to accelerate following default is left to the Lender(s) discretion. A "responsible and prudent" standard of care is imposed on the Lender in the exercise of its rights and the performance of its obligations. Upon payment of the guaranteed amount to the Lender, the Board does have the right to participate in such decisions.

Refer to Reg.: See Sec. 500.212

Question #33: *Could you better identify the reporting requirements of the Lenders under the Program?*

Response: A form of "Quarterly Compliance Statement" is provided as an exhibit to the Guarantee Agreement.

Refer to Reg.: See Sec. 500.211(f)(3)

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